



Issue Date February 8, 2006

Audit Report Number 2006-PH-1006

TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal Housing
Commissioner, H

FROM:  John P. Buck, Regional Inspector General for Audit, Philadelphia Regional
Office, 3AGA

SUBJECT: Allied Mortgage Group, Bala Cynwyd, Pennsylvania, Issued and Submitted for
Endorsement Loans with an Increased Risk of Defaults and Claims

HIGHLIGHTS

What We Audited and Why

We audited Allied Mortgage Group (Allied), a non-supervised direct endorsement lender approved to originate Federal Housing Administration single-family mortgage loans because its default rate was above the national average default rate. Our audit objective was to determine whether Allied complied with the U.S. Department of Housing and Urban Development's (HUD) regulations, procedures, and instructions in the origination of Federal Housing Administration loans.

What We Found

Allied did not originate all Federal Housing Administration loans in accordance with HUD's loan origination requirements. Of the 28 loans we selected for review,¹ Allied did not fully comply with Federal Housing Administration requirements for 10 of the loans valued at \$799,571. Allied did not exercise due diligence in the review of assets and liabilities, did not ensure all borrowers met the minimum required three percent investment in the property, and did not verify rental history.

¹ Originally valued at \$2,623,822

These deficiencies were caused by a lack of due professional care and contributed to an increased risk to the Federal Housing Administration insurance fund.

In addition, Allied charged ineligible commitment fees and overcharged for credit reports contrary to HUD regulations. For 11 of the 28 cases reviewed, fees and expenses totaling \$1,207 were charged to borrowers. As a result, borrowers incurred unnecessary costs.

Further, Allied did not establish and implement a quality control plan in accordance with HUD regulations. Allied's plan does not include all elements required by HUD. In addition, the reviews performed by the contractor hired by Allied did not address all items identified in Allied's quality control plan. As a result, some HUD-required elements were not addressed when the quality control reviews were performed by the contractor.

What We Recommend

We recommend that the assistant secretary for housing – federal housing commissioner

- Request from Allied an indemnification of \$595,418 on seven loans, which it issued contrary to HUD's loan origination procedures, and reimburse HUD \$204,153 on three loans that went into default, causing HUD to pay a claim.
- Require Allied to develop internal procedures to more closely monitor its underwriting procedures.
- Require Allied to reimburse borrowers the balance of \$1,011 (of the \$1,207 in overcharges, \$196 has already been reimbursed by Allied) that Allied erroneously charged them.
- Require Allied to revise and implement its quality control plan to comply with HUD requirements.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided Allied a discussion draft on December 29, 2005, and held an exit conference on January 30, 2006. We received written comments from Allied on January 30, 2006. Allied generally agreed with our findings and recommendations. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The U.S. Department of Housing and Urban Development's (HUD) strategic plan states that part of its mission is to increase homeownership, support community development, and increase access to affordable housing free from discrimination.

The National Housing Act, as amended, established the Federal Housing Administration, an organizational unit within HUD. The Federal Housing Administration provides insurance for lenders against loss on single-family home mortgages.

Beginning in 1983, HUD implemented the direct endorsement program, which authorized approved lenders to underwrite loans without HUD's prior review and approval. HUD can place them on credit watch status or terminate their approval if their rate of defaults and claims exceeds the normal rate for the area. Many sanctions are available for taking actions against lenders or others who abuse the program.

The Bala Cynwyd office of Allied Mortgage Group (Allied) is the main office and includes five additional active branches with direct endorsement approval. Allied issued 632 Federal Housing Administration loans worth \$65,499,728 between May 1, 2003, and April 30, 2005. Of the 632 loans issued, 45 loans worth \$4,435,945 went into default within the first two years. Of these, we reviewed 28 loans worth \$2,623,822 that were in default status with 12 payments or fewer after closing.

The specific objectives of our review were to determine whether Allied originated Federal Housing Administration-insured loans in accordance with prudent lending practices and HUD requirements and whether the lender implemented a quality control plan that meets HUD's requirements. We reviewed case files from both the homeownership center and the lender and reviewed Allied's oversight of its branches.

RESULTS OF AUDIT

Finding 1: Allied Did Not Fully Comply with HUD/Federal Housing Administration Requirements When Originating Loans

Allied did not always originate Federal Housing Administration-insured loans in accordance with HUD requirements. For 10 of the 28 loans we reviewed, originally valued at \$2,623,822, Allied did not exercise due diligence in the review of assets and liabilities, did not ensure all borrowers met the minimum required three percent investment in the property, and did not verify rental history. The deficiencies stemmed from a lack of due professional care and contributed to an increased risk to the Federal Housing Administration insurance fund. Therefore, Allied should indemnify the seven loans with remaining balances of \$595,418 and reimburse HUD \$204,153 on three loans that went into default causing HUD to pay a claim.

Allied Did Not Properly Verify the Borrower's Funds to Close

According to HUD guidance, all funds for the borrower's investment must be verified and documented. Acceptable sources of these funds include but are not limited to the following: earnest money deposit, savings and checking accounts, and gift funds. For nine of the cases reviewed, Allied did not properly verify the borrower's funds to close. In case number 351-4453528, the borrower only provided one month's bank statement from a recently opened account. The statement contained a deposit of \$4,171 with a handwritten note stating it was a tax refund. There was no additional documentation to support the tax refund.

Allied Did Not Obtain Required Documentation for Derogatory Credit

According to HUD requirements, when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including delayed mail delivery or disputes with creditors. Indications of derogatory credit—including judgments, collections, and any other recent credit problems—require sufficient written explanation from the borrower. For case file number 441-7244918, the buyer had collection accounts within a year of closing, with one being paid off just before closing.

There was nothing in the file from the borrower to explain the delinquent accounts.

Allied Did Not Ensure That the Borrower Met the Minimum Required Investment

According to HUD guidance, the property's sales price is multiplied by a loan-to-value ratio, and the resulting amount is the maximum mortgage that the Federal Housing Administration will insure. The borrower must make a cash investment at least equal to the difference between the sales price and the resulting maximum mortgage amount. The investment must be at least three percent of the contract sales price. Borrower-paid closing costs may be used to meet the three percent minimum cash investment. However, if the borrower pays no closing costs at settlement, the loan amount must be reduced sufficiently so that the three percent minimum cash investment is met. For one of the cases reviewed, Allied did not ensure that the borrower met the minimum three percent required investment. In case number 351-4448166, the borrower's minimum required investment was short by more than \$1,400. In addition, the earnest money deposit was not adequately supported on three loans causing the minimum required investment to be unsupported.

Allied Did Not Verify the Rental History of All Borrowers

HUD requires the lender to determine the borrower's payment history of housing obligations covering the most recent 12-month period. For one of the cases reviewed, Allied did not properly verify the previous rental history of the borrower. In case number 441-7202165, the borrower claimed a rental history of two years at a stated location but did not provide documentation to support this claim.

Conclusion

The above discrepancies represent material deficiencies that require administrative action up to and including indemnification. The cases illustrate that HUD assumed unnecessarily high risk when insuring the loans originated by Allied. The deficiencies associated with Allied's loan origination activities stem from the lack of due care in applying HUD loan requirements. Therefore, Allied should indemnify seven loans with a remaining balance of \$595,418 and reimburse HUD \$204,153 for three loans in which a claim was paid. See appendix

C for the schedule of case file discrepancies and appendix E for the narrative case presentations, which contain the specific HUD requirements cited.

Recommendations

We recommend that the assistant secretary for housing – federal housing commissioner

- 1A. Request indemnification from Allied on seven loans issued with current unpaid balances of \$595,418, in which Allied's loan origination procedures did not comply with HUD requirements and reimburse HUD \$204,153 on three loans that went into default causing HUD to pay a claim.
- 1B. Require Allied to develop internal procedures to more closely monitor its underwriting procedures.

Finding 2: Allied Charged Ineligible Commitment Fees and Overcharged for Credit Reports

Allied charged ineligible commitment fees and overcharged for credit reports contrary to HUD regulations. For 11 of the 28 cases reviewed, fees and expenses totaling \$1,207 were charged to borrowers. As a result, borrowers incurred unnecessary costs.

Allied Charged Borrowers Ineligible Commitment Fees

HUD Handbook 4000.2, paragraph 1-9, provides that lenders are permitted to charge a commitment fee to guarantee, in writing, the interest rate and discount points for a specific period or to limit the extent they may change. Lenders are expected to honor such commitments. Allied charged ineligible commitment fees in 6 of the 28 loans reviewed totaling \$970. Of the six loans, three lacked documentation to substantiate that the borrowers agreed to lock in their loans; two contained lock-in agreements signed by the borrowers indicating they did not want an interest rate commitment; and one had a signed lock-in agreement form, but the borrower did not choose an option to lock in or not lock in.

Allied Overcharged Borrowers for Credit Report Fees

HUD Handbook 4000.2, paragraph 5-2, identifies the type of costs, such as obtaining credit report fees, that a lender is allowed to charge a borrower. The charges are limited to actual cost. Allied overcharged borrowers for credit report fees in 8 of the 28 loans reviewed. The overcharges totaled \$237. After we brought the matter to Allied's attention, it reimbursed seven of the borrowers \$196.

A listing of the fees is presented in appendix D.

Recommendations

We recommend that the assistant secretary for housing – federal housing commissioner

- 2A. Request Allied to reimburse borrowers the balance of \$1,011 (\$970 for commitment fees and \$41 for credit report fees) out of \$1,207 that Allied erroneously charged them.

Finding 3: Allied's Quality Control Plan Did Not Fully Comply with HUD Requirements

Allied did not establish and implement a quality control plan in accordance with HUD requirements. Allied's plan does not include all elements required by HUD. As a result, these elements were not addressed when the quality control reviews were performed by the contractor hired by Allied. In addition, the reviews performed by the contractor did not address all items identified in Allied's quality control plan.

Written Quality Control Plan Did Not Contain Required Elements

HUD Handbook 4060.1, chapter 6, states that approved lenders must have and maintain a quality control plan for the origination and servicing of insured mortgages. The quality control plan must be a prescribed function of the lender's operations and assure that the lender maintains compliance with HUD requirements and its own policies and procedures.

Allied's quality control plan did not include the following elements:

- Determine whether verification of employment, verification of deposit, or credit reports are suspect due to handling by any interested third party or the borrower.
- Determine whether there are sufficient and documented compensating factors if the debt ratios exceed Federal Housing Administration limits.
- Assure that only Federal Housing Administration-allowable fees and charges were paid by the borrower. The HUD-1 settlement sheet should be compared with other relevant loan documents to determine whether the borrower made the required minimum investment and whether any credits resulted in an overinsured mortgage.
- Determine whether the seller acquired the property at the time of or soon before closing, indicating a possible property "flip."

Quality Control Reviews Were Not Performed in Accordance with Allied's Plan

In addition to the elements listed above, the quality control reviews, as performed by the contractor hired by Allied, did not address the following items in Allied's quality control plan:

- Meeting minimum safety requirements;
- Performing field reviews when property values increase 20 percent or more within 12 months;
- Meeting self-employed borrower's income requirements;
- Submitting all credit reports to HUD if more than one is ordered;
- Clearing all conditions before closing;
- Determining whether the loan was up to date if submitted for endorsement more than 60 days after closing;
- Documenting evidence of strawbuyer;
- Identifying employees who are debarred, suspended, or subject to limited denial of participation.

Conclusion

Because Allied's quality control process did not comply with HUD requirements, HUD lacks assurance that it was protected from unacceptable risk; guarded against errors, omissions, and fraud; and assurance that swift and appropriate corrective action would be taken when necessary in the origination and servicing of Federal Housing Administration loans.

Recommendations

We recommend that the assistant secretary for housing – federal housing commissioner

- 3A. Require Allied to revise and implement its quality control plan in accordance with HUD requirements.

SCOPE AND METHODOLOGY

To accomplish our objectives we

- Reviewed Federal Housing Administration-insured loans (28 cases) originated by Allied's main office between May 1, 2003, and April 30, 2005, that had gone into default at least once. The 28 loans were part of a universe of 632 loans originated by Allied's main office during that time. The results of the detailed testing apply to the 28 loans reviewed only and cannot be projected to the universe of Federal Housing Administration-insured loans.
- Examined records and related documents of Allied.
- Reviewed applicable HUD handbooks and mortgagee letters.
- Conducted interviews with officials and employees of Allied and the HUD Quality Assurance Division.

In addition, we relied in part on data maintained by HUD in the Single Family Data Warehouse and Neighborhood Watch systems. We did not perform a detailed analysis of the reliability of these programs.

The audit generally covered the period from May 1, 2003, to April 30, 2005. This period was expanded to include the most current data while performing our audit. Therefore, when applicable, the audit period was expanded to include data through August 31, 2005. We conducted our fieldwork from June through September 2005.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Loan origination process – Policies and procedures that management has in place to reasonably ensure that the loan origination process complies with HUD program requirements.
- Quality control plan – Policies and procedures that management has in place to reasonably ensure implementation of HUD quality control requirements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe Allied did not operate in accordance with HUD requirements as they relate to loan issuance and quality control.

The deficiencies are discussed in detail in the Results of Audit section of this report.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A		\$204,153	\$595,418
2A	\$1,011		

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Page 1 of 3

Denise Gimbel

From: "Denise Gimbel" [REDACTED]
To: [REDACTED]
Cc: [REDACTED]
Sent: Monday, January 30, 2006 1:32 PM
Subject: This is also being faxed

To: The Office of the Inspector General, Phil Griffin
Re: Audit of Allied Mortgage Group

Please find the remainder of Auditee comments that were not provided in writing to you earlier today 1/30/06:

Individual Loan Review:

441-720216-5

We concur that the landlord reference is missing from the file.
We did not receive the HUD 1 from the title company and would not have allowed this loan to close if we had.
We now condition our loan approvals as such to include a maximum bottom line that the borrower can afford to pay without the loan being re-underwritten.

441-725167-1

We dispute the finding regarding non support of 2 \$500 deposits into borrower's bank account.
Please see 6/03 bank statement where it is noted that after backing out this \$1000, borrower still had \$2314 in assets and according to HUD 1 needed only \$2078 (more than 3%) to complete transaction.

351-445352-8

We concur that the evidence of tax refund is missing from file, however, the borrower has agreed to supply us with another copy and we will forward upon receipt.

351-444816-6

1/30/2006



Comment 4

We did not receive the HUD 1 from the title company and would not have allowed this loan to close if we had.
Our loan approvals are conditioned for the HUD 1 to evidence the 3% minimum prior to disbursement.

Comment 5

441-740926-7
We concur with your findings.

Comment 6

The fees in question will all be refunded. I will fax copies of the checks when ready. This will be requested of our accounting department today.

Comment 7

Our quality control plan has been revised and a copy given to you today.

Comment 8

We are committed to more closely monitoring our underwriting procedures. Many changes were implemented even before this audit took place. For example:
We now require 2 DE underwriters to review any file with ratios above 45% to warrant approval.

Page 2 continued

We are now scanning, rather than photocopying our loan files to limit the loss of documents.

We now require any borrower not contributing any funds of his/her own into transaction to complete a homebuyer education course and the same for any borrower without a current housing expense.

We will institute a procedure with our post-closing department to bring the HUD 1 to the DE's attention after closing so that if it had not been sent prior to disbursement we may still review it in a more timely fashion and resolve any issues.

In closing, I maintain that our current delinquency ratio should be considered in the final draft. The above changes contributed to this sizable reduction. In addition, please note that 45% of the delinquencies occurred due to extenuating circumstances. 41% were originated by loan officers who through mutual decision no longer work for Allied.

1/30/2006

Page 3 of 3

Thank you for your time. I will not be back in the office full time until 2/6/06.
I can always be reached though at [REDACTED]

1/30/2006

Comment 9

7 Bala Avenue
Bala Cynwyd, Pa. 19004
Ph-610-660-4719

January 16, 2006

Re: [REDACTED]
441-72449487

- 1) The borrower had paid the collection account as per the letter enclosed.
- 2) The borrower explained the lateness due to unemployed but did not explain all delq. And inq. This was an oversight

Thank you for your cooperation in this matter, if you have any questions please feel free to contact me at 610-660-4719 or e mail me at [REDACTED]

Sincerely,

LaNora B. DiStasio
AQ96

Comment 10

Allied Mortgage Group
7 Bala Avenue
Bala Cynwyd, Pa. 19004
Ph-610-660-4719

January 16, 2006

Re: [REDACTED]
441-

- 1) The borrower had received gift funds to pay off accounts from [REDACTED] that was given directly to the Realtors for escrow deposit 1/16/04 \$1500.00 and \$2500.00 & Home Inspection \$875.00 & Allied Mortgage for Appraisal Fee & lock in fee \$1739.00.
- 2) The borrower also received an Insurance Settlement in the amount of \$7395.50; he only deposited the funds in the amount of \$6972.87 on 2/04. He also cashed in his 401K in the amount of \$42410.00 on 1/9 and deposited the funds of \$27000.00 on 1/20 into his account.
- 3) The borrower paid off the following accounts 1/15 [REDACTED] \$1150.00, [REDACTED] \$30.00, [REDACTED] \$15.00, [REDACTED] \$639.23, [REDACTED] \$268.25, [REDACTED] \$493.64, [REDACTED] \$125.12 on 1/20 and Appraisal Fee \$375.00 on 1/20 than [REDACTED] \$328.33 on 1/22 and [REDACTED] \$6816.56 on 1/23.
- 4) The assets given to allied POC = \$1739.00 the escrow deposit given was \$4000.00, the home inspection that was not shown on the HUD-1 of \$ 875.00 that was POC = a total of \$6614.00, although these funds were from gift monies, these funds are considered in the 3% vested into the transaction.
- 5) All accounts paid off had cleared the bank accounts from the borrower 1/23 and the account balance in the borrower's account 2/03 was \$14677.04.
- 6) The borrower needed for closing \$8120.20 and a certified check in the amount of \$10000.00 was given to the Title Co. on 1/26/04, evidencing sufficient funds to close and additional funds vested into the transaction.

Thank you for your cooperation in this matter, if you have any questions please feel free to contact me at 610-660-4719 or e mail me at [REDACTED].

Sincerely,

LaNora B. DiStasio
AQ96

Comment 11

**Allied Mortgage Group
7 Bala Avenue
Bala Cynwyd, Pa. 19004
Ph-610-660-4719**

January 16, 2006

Re: [REDACTED]
441-7338279

- 1) The borrower made all escrow deposits via money orders, saved at home funds. See attached money orders and escrow letter.
- 2) The borrower explained that for several months he saved \$751.00 per month for the escrow deposit: 7/31 = 2 months savings (5/03 & 6/03) for first escrow deposit, 2 months savings (7/03 & 8/03) for the second escrow deposit. The borrower opened a bank account and proceeded to deposit funds. He gave a bank check in the amount of \$1900.00. I deducted the \$1900.00 from the balance stated on the bank printout 11/01 since the printout did not reflect this based on the date of the bank check and the printout being the same date. (withdrawals do will not be reflected until the next business day)
- 3) The borrower also stated that other expenses were being taken from additional household income; I did not request evidence of the additional household income.
- 4) The escrow deposit monies reflected on the HUD-1 was reduced by the amount the Realtor had given Allied for the appraisal etc, as per the attached.
- 5) Shown is the 3% of the borrowers own funds vested into the transaction.

Thank you for your cooperation in this matter, if you have any questions please feel free to contact me at 610-660-4719 or e mail me at [REDACTED]

Sincerely,

LaNora B. DiStasio
AQ96

Comment 12

**Allied Mortgage Group
7 Bala Avenue
Bala Cynwyd, Pa. 19004
Ph-610-660-4719**

January 16, 2006

Re: [REDACTED]
441-74741587

- 1) The borrower had received gift funds to pay off accounts with other assets as traced and verified, see attached.
- 2) The borrower paid off 2 collection accounts at the closing, [REDACTED]
- 3) After reviewing the HUD-1 the borrower The borrower needed 2575.25 and I traced the Escrow deposit of \$2500.00 and the POC to Allied \$350.00 and with the grant funds of \$2962.38 the 3% vested is verified and traced. See attached.
- 4) The borrower explained the lateness as per the attached.

Thank you for your cooperation in this matter, if you have any questions please feel free to contact me at 610-660-4719 or e mail me at [REDACTED].

Sincerely,

LaNora B. DiStasio
AQ96

Comment 13

**Allied Mortgage Group
7 Bala Avenue
Bala Cynwyd, Pa. 19004
Ph-610-660-4719**

January 16, 2006

Re: [REDACTED]
441-7274716

- 1) I did not use or trace the escrow deposit because it was not needed as of the underwriting of the loan.
- 2) Although the Escrow deposit was not used in the underwriting of the loan the settlement sheet reflects the escrow deposit of \$2100.00, as per the A/S the deposit was \$2000.00 and based on the guidelines as of the date of underwriting 2% could have been used without tracing, \$1398.00 and with the grant funds that were indicated on the HUD-1 the borrower would have had 3% vested.
- 3) Grant funds were use in the amount of \$2621.00 in excess of 3%. But at closing the Grant were reduced to \$1965.75, the lender was not advised or this change.
- 4) The borrower had in here account as verified \$711.00, this would have been sufficient for the borrower to close on the loan

Thank you for your cooperation in this matter, if you have any questions please feel free to contact me at 610-660-4719 or e mail me at [REDACTED].

Sincerely,

LaNora B. DiStasio
AQ96

OIG Evaluation of Auditee Comments

Comment 1 - Case File 441-7202165

Allied concurred and has added new policy. The case remains in the report.

Comment 2 - Case File 441-7251671

Allied stated that the borrower would still have the funds to close if the \$1,000 was backed out. Allied is using the total deposits for the month minus the \$1,000 in question and not taking into account the checks and withdrawals the buyer made during the month. The ending statement balance (two weeks before settlement) was \$191.99. Further, the borrower needed the \$1,000 to meet the three percent minimum investment requirement. The case remains in the report.

Comment 3 - Case File 351-4453528

Allied stated that the borrower agreed to provide a copy of the tax refund (no copy has been received to date). However, the tax refund was not in the file when the loan was approved, thus, the assets claimed were not supported when the loan was approved. The case remains in the report.

Comment 4 - Case File 351-4448166

Allied concurred. The case remains in the report.

Comment 5 - Case File 441-7409267

Allied concurred. The case remains in the report.

Comment 6 - Overcharged Fees

Allied agreed to refund the fees. As of the date of this report, although Allied provided copies of checks to borrowers, no documentation to verify payment of the refunds has been provided.

Comment 7 - Quality Control Plan

Allied's revised Quality Control Plan did not specifically address two of the four elements in our finding (specifically, high ratios and fee overcharges). In addition, Allied did not provide documentation to show that the contractor hired by Allied to perform the quality control reviews received an updated Quality Control Plan.

Comment 8 - Underwriting Procedures

We are encouraged to know the many changes that were implemented in Allied's underwriting procedures.

Comment 9 - Case File 441-7244918

Allied provided support that the borrower paid off a collection account. We changed the wording in finding 1 and appendix E. However, Allied agreed that it did not obtain an explanation from the borrower on late payments. The case remains in the report.

Comment 10 - Case File 441-7443619

Allied provided no additional information. The underwriter is claiming a balance of \$14,677 on 2/3/04 (settlement was 2/27/04) but a later bank statement (2/18/04) shows a balance of \$1,574. There is a certified check for \$10,000 but there are no bank records showing the money coming from the borrower's account. The case remains in the report.

Comment 11 - Case File 441-7338279

Allied provided no additional information. Allied did not verify the claimed "other income" from the home. The ability of the buyer to save the funds was not thoroughly documented. The case remains in the report.

Comment 12 - Case File 441-7475158

Allied provided no additional information. Allied provided bank statements that were supposed to be from the donor but, the statements have nothing identifying the owner of the account. In addition, the numerous withdrawals that Allied identifies as being the gift funds cannot be directly linked to the gift. The case remains in the report.

Comment 13 - Case File 441-7274716

Allied's comments are not supported. During the exit conference Allied verbally concurred. The case remains in the report.

Appendix C

SCHEDULE OF CASE FILE DISCREPANCIES

Case number	Mortgage amount	Unpaid principal balance*	Claim paid	Inadequate rental history	Unsupported assets	Credit problems	Unsupported fees charged to buyer **	Minimum required investment not met
441-7244918	\$76,277	\$81,916	\$0			X	X	
441-7443619	\$176,559	\$174,883	\$0		X			
441-7409267	\$54,468	\$0	\$56,127		X			X***
441-7338279	\$46,106	\$0	\$53,055		X	X	X	X***
441-7475158	\$90,435	\$0	\$94,971		X			
351-4453528	\$57,596	\$56,894	\$0		X			
351-4448166	\$93,532	\$92,185	\$0		X			X
441-7274716	\$69,351	\$68,424	\$0		X			X***
441-7251671	\$68,458	\$67,689	\$0		X			
441-7202165	\$54,568	\$53,427	\$0	X	X		X	
Totals	\$787,350	\$595,418	\$204,153	1	9	2	3	4
* Neighborhood Watch - default information provided by servicer								
** The chart only reflects the unsupported fees for cases where an indemnification is being requested. See appendix D for a listing of all fees.								
*** Since the earnest money deposit could not be supported, the minimum required investment is not supported.								

Appendix D

SCHEDULE OF INELIGIBLE AND OVERCHARGED FEES

Case number	Ineligible commitment fees	Overcharged credit report fees
241-7102760	\$125.00	\$ 26.15 (buyer reimbursed by Allied)
441-7244918	\$100.00	
441-7223930	\$ 70.00	\$ 16.00 (buyer reimbursed by Allied)
249-4617982	\$425.00	\$ 7.50 (buyer reimbursed by Allied)
441-7302041	\$125.00	
351-4526966	\$125.00	
351-4506541		\$ 53.53 (buyer reimbursed by Allied)
441-7164327		\$ 36.00 (buyer reimbursed by Allied)
441-7202165		\$ 41.00
441-7338279		\$ 15.99 (buyer reimbursed by Allied)
441-7201702		\$ 41.00 (buyer reimbursed by Allied)
Total: 11 cases	\$970.00	\$237.17

Appendix E

NARRATIVE CASE PRESENTATIONS

Case number: 441-7244918

Mortgage amount: \$76,277

Date of loan closing: June 13, 2003

Status: Reinstated by borrower who retains ownership

Payments before first default reported: Six

Unpaid principal balance: \$81,916

Summary:

Allied (1) did not obtain required documentation to approve the loan and (2) charged a commitment fee without a lock-in agreement.

Pertinent Details:

Required Documentation Was Not Obtained

When delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including delayed mail delivery or disputes with creditors. Indications of derogatory credit – including judgments, collections, and any other recent credit problems – require sufficient written explanation from the borrower (HUD Handbook 4155.1, paragraph 2-3). In this case, the buyer had collection accounts within a year of closing and there was nothing in the file from the borrower to explain the late payments.

Allied Charged a Lock-in Fee without a Written Agreement

Lenders are permitted to charge a commitment fee/lock-in fee to guarantee an interest rate and discount points. The guarantee must be in writing (HUD Handbook 4000.2, paragraph 1-9). Allied charged a lock-in fee without a written agreement.

Case number: 441-7443619

Mortgage amount: \$176,559

Date of loan closing: February 27, 2004

Status: Partial reinstatement

Payments before first default reported: Seven

Unpaid principal balance: \$174,883

Summary:

Allied did not properly verify the borrower's funds to close.

Pertinent Details:

Funds to Close Were Not Properly Verified or Supported

A verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase, the lender must verify the source of funds (HUD Handbook 4155.1, paragraph 2-10B). All funds for the borrower's investment in the property were not properly verified. The borrower withdrew \$27,000 from his retirement account and is claiming \$10,000 was used for settlement costs. However, the money was used to pay off several bills and was depleted two weeks before settlement.

Case number: 441-7409267

Mortgage amount: \$54,468

Date of loan closing: December 3, 2003

Status: Claim paid

Payments before first default reported: Four

Claim Paid: \$56,127

Summary:

Allied did not properly verify the borrower's funds to close and ensure that the borrower met the minimum required investment in the property.

Pertinent Details:

Allied Did Not Properly Verify the Borrower's Funds to Close and Ensure the Borrower Met the Minimum Required Investment in the Property

All funds for the borrower's investment in the property were not properly verified. The earnest money deposit exceeded two percent of the sales price and Allied did not verify the source of these funds. Since the earnest money deposit was not supported, the borrower's minimum required investment in the property could not be guaranteed. Specifically, there were two unexplained \$500 deposits made within four days of the \$1,500 escrow check. These were not payroll deposits and Allied did not properly verify the source of the funds. HUD regulations require the borrower to make a cash investment of at least three percent of the property value. Earnest money deposits and closing costs may be used to meet the three percent requirement (HUD Handbook 4155.1, paragraphs 1-7 and 2-10A). If the earnest money exceeds two percent of the sales price, the lender must verify the source of these funds (HUD Handbook 4155.1, paragraph 2-10A). A verification of deposit, along with the most recent bank statement may be used to document the funds; however, if there is a large increase to the bank account, the lender must verify the source of the funds (HUD Handbook 4155.1, paragraph 2-10B).

Case number: 441-7338279

Mortgage amount: \$46,106

Date of loan closing: November 5, 2003

Status: Claim paid

Payments before first default reported: Three

Claim Paid: \$53,055

Summary:

Allied did not (1) properly verify the borrower's funds to close and ensure the borrower met the minimum required investment in the property, and (2) verify nontraditional credit. Also, Allied overcharged the borrower for the credit report.

Pertinent Details:

Allied Did Not Properly Verify the Borrower's Funds to Close and Ensure the Borrower Met the Minimum Required Investment in the Property

All funds for the borrower's investment in the property were not properly verified. The earnest money exceeded two percent of the sales price and Allied did not verify the source of the funds. Since the earnest money deposit was not supported, the borrower's minimum required investment in the property could not be guaranteed. Specifically, the borrower is claiming \$4,600 in an escrow account held by the seller. The borrower earned grossed up Social Security income of \$1,333 per month (\$1,158 actual). According to a letter provided by the borrower, he lived with family and spent only \$350 per month for food for himself and five dependents. The rest of the funds were saved at home. The period of savings was not specified, only listed as several months. There is no documentation in the file that shows the underwriter attempted to verify this information beyond the letter from the buyer. Although there are money orders and an escrow letter, the source of the funds was not determined; in part, because the holder of the escrow account is also the seller. HUD regulations require the borrower to make a cash investment of at least three percent of the property value. Earnest money deposits and closing costs may be used to meet the three percent requirement (HUD Handbook 4155.1 paragraphs 1-7 and 2-10A). If the amount of the earnest money deposit exceeds two percent of the sales price, the lender must verify with documentation the deposit amount and the source of funds (HUD Handbook 4155.1, paragraph 2-10A). Borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. The lender must determine the reasonableness of the accumulation of the funds based on the borrower's income stream, the period during which the funds were saved, the borrower's spending habits, documented expenses, and the borrower's history of

using financial institutions (HUD Handbook 4155.1, paragraph 2-10M). Allied did not properly verify the source of these funds.

Allied Did Not Verify Nontraditional Credit

The borrower did not have a traditional credit history and Allied did not verify the nontraditional credit information provided as support for the loan. The borrower claims he currently lives with family. However, the borrower provided two non-traditional creditor letters including one from a former landlord as proof of a timely payment history. HUD requires the lender to document that the providers of nontraditional credit exist and verify the credit information (HUD Handbook 4155.1, paragraph 2-3). Allied did not independently verify the validity of these creditors.

Allied Overcharged the Borrower for the Credit Report

Customary and reasonable fees and charges may be collected from the borrower by the lender. The cost for any item charged to the borrower must not exceed the cost paid by the lender or charged to the lender by the service provider (HUD Handbook 4000.2, paragraph 5-2). Allied overcharged the borrower for the credit report.

Case number: 441-7475158

Mortgage amount: \$90,435

Date of loan closing: April 30, 2004

Status: Claim paid

Payments before first default reported: Five

Claim Paid: \$94,971

Summary:

Allied did not properly verify the borrower's funds to close.

Pertinent Details:

Allied Did Not Properly Verify the Borrower's Funds to Close

The lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, that specifies the dollar amount of the gift; states that no repayment is required; shows the donor's name, address, and telephone number; and states the nature of the donor's relationship to the borrower. In addition, the lender must document the transfer of funds from the donor to the borrower. If the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that shows the deposit is also required (HUD Handbook 4155.1, paragraph 2-10C). In this case, Allied did not show the withdrawal from the donor's account.

Case number: 351-4453528

Mortgage amount: \$57,596

Date of loan closing: July 17, 2003

Status: Foreclosure started

Payments before first default reported: Three

Unpaid principal balance: \$56,894

Summary:

Allied did not properly verify the funds to close.

Pertinent Details:

Allied Did Not Properly Verify the Funds to Close

A verification of deposit along with the most recent bank statement may be used to verify savings and checking accounts. If a verification of deposit is not available, the lender may obtain original bank statement(s) covering the most recent three-month period. If there is a large increase or the account was recently opened, the lender must verify the source of funds (HUD Handbook 4155.1, paragraphs 2-10B and 3-1F). Further, if the amount of the earnest money deposit exceeds 2 percent of the sales price, the lender must verify with documentation the deposit amount and the source of funds (HUD Handbook 4155.1, paragraph 2-10A). In this case, the borrower only provided one month's bank statement from a recently opened account. The statement contained a deposit of \$4,171 with a handwritten note stating it was a tax refund. There is no support for the tax refund. These funds were used for the earnest money deposit. The deposit exceeds 2 percent of the sales contract price and must be supported.

Case number: 351-4448166

Mortgage amount: \$93,532

Date of loan closing: July 18, 2003

Status: Foreclosure started

Payments before first default reported: Four

Unpaid principal balance: \$92,185

Summary:

Allied did not ensure the borrower met the minimum required investment.

Pertinent Details:

Allied Did Not Ensure the Borrower Met the Minimum Required Investment

Allied did not ensure that the borrower met the three percent minimum required investment in the property as required by HUD regulations (HUD Handbook 4155.1, paragraph 1-7). Based on the property's value, the minimum required investment should be \$2,850; however, the buyer invested less than \$1,400 in the property. Review of the borrowers' bank statement shows that the borrower did not have the necessary funds to meet the investment requirement.

Case number: 441-7274716

Mortgage amount: \$69,351

Date of loan closing: July 3, 2003

Status: First legal action to commence foreclosure

Payments before first default reported: 11

Unpaid principal balance: \$68,424

Summary:

Allied did not properly verify the funds to close and ensure the borrower met the minimum required investment.

Pertinent Details:

Allied Did Not Properly Verify the Funds to Close and Ensure the Borrower Met the Minimum Required Investment

The earnest money deposit exceeded two percent of the sales contract. In addition, since the earnest money deposit was not supported, the borrower's minimum required investment in the property could not be guaranteed. HUD regulations require the borrower to make a cash investment of at least three percent of the property value. Earnest money deposits and closing costs may be used to meet the three percent requirement (HUD Handbook 4155.1, paragraphs 1-7 and 2-10A). However, if the earnest money exceeds two percent of the sales price, the lender must verify the source of these funds (HUD Handbook 4155.1, paragraph 2-10A). Allied did not properly verify the source of the funds.

Case number: 441-7251671

Mortgage amount: \$68,458

Date of loan closing: June 20, 2003

Status: Foreclosure started

Payments before first default reported: Nine

Unpaid principal balance: \$67,689

Summary:

Funds to close were not properly verified or supported.

Pertinent Details:

Funds to Close Were Not Properly Verified or Supported

The HUD-1 settlement sheet shows a \$1,500 earnest money deposit which exceeds two percent of the sales price. HUD requires the lender to verify the source of funds for earnest money deposits exceeding two percent of the sales price (HUD Handbook 4155.1, paragraph 2-10A). We have support for \$500. However, the bank statements show two unexplained \$500 deposits just days before a \$1,000 check was written. The bank statement contained a handwritten note identifying the check as an escrow check. There is no copy of the escrow check in the file or an explanation of the source of the two deposits (the borrower's payroll checks are directly deposited so the deposits do not appear to be payroll). HUD requires a verification of deposit, along with the most recent bank statement, to verify savings and checking accounts. If there is a large increase or the account was recently opened, the lender must verify the source of funds (HUD Handbook 4155.1, paragraph 2-10B). Allied did not verify the source of the two \$500 deposits.

Case number: 441-7202165

Mortgage amount: \$54,568

Date of loan closing: June 13, 2003

Status: Partial reinstatement

Payments before first default reported: 12

Unpaid principal balance: \$53,427

Summary:

Allied did not (1) properly verify funds to close, and (2) include in the loan origination file or case binder a proper determination of the borrower's payment history of housing obligations. Also, Allied overcharged the borrower for the credit report.

Pertinent Details:

Allied Did Not Properly Verify Funds to Close

When standard documentation does not provide enough information to support the lender's decision to approve the loan, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or to supplement the documentation submitted by the borrower (HUD Handbook 4155.1, paragraph 3-1). The buyer used earnest money and seller assistance to pay for closing costs, which were both supported. At settlement, the buyer needed an additional \$1,254 to close. Based on the bank accounts provided, the borrower did not have the additional \$1,254 at closing. Allied provided no additional documentation to support the funds to close and its decision to approve the loan.

Allied Did Not Include in the Loan Origination File or Case Binder a Proper Determination of the Borrower's Payment History of Housing Obligations

The borrower had no traditional credit history but claimed a rental history of two years. Allied did not include in its loan origination file or case binder a determination of the borrower's payment history of housing obligations through either the credit report, directly from the landlord or mortgage servicer, or through canceled checks covering the most recent 12-month period (HUD Handbook 4155.1, paragraph 2-3A).

Allied Overcharged the Borrower for the Credit Report

Customary and reasonable fees and charges may be collected from the borrower by the lender. The cost for any item charged to the borrower must not exceed the cost paid by

the lender or charged to the lender by the service provider (HUD Handbook 4000.2, paragraph 5-2). Allied overcharged the buyer for the credit report.